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BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON DC 20268-0001

POSTAL RATE AND FEE CHANGES, 2000	**) Docket No. R2000-1**

INITIAL BRIEF

OF

MAIL ORDER ASSOCIATION OF AMERICA

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STATEMENT OF THE CASE AND
STATEMENT OF POSITION

The issues that will be addressed by the Mail Order Association of America in this brief are the rates that have been proposed by the Postal Service for Standard Mail A ECR and Bound Printed Matter, and whether the Commission should substitute FY99 cost data for the base year filing made by the Postal Service.[1] The issues concerning the rates for the Standard Mail A ECR subclass is whether the Postal Service has properly applied the rate-making criteria of the Act and in particular the "value of service" portion of factor 2 of the Act, and the extent to which competitors of the Postal Service have provided any basis for increasing the rates for Standard Mail A ECR. In addition, the brief addresses the issue of the proper rates for Bound Printed Matter and the extent to which the Postal Service has proposed an appropriate cost coverage for Bound Printed Matter and appropriate discounts for entry at the Destination Delivery Unit.

It is the position of MOAA that the Postal Service has proposed ECR rates that are excessive. As proposed by the Postal Service, the ECR cost coverage would be

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[1] Additionally, MOAA has joined in a joint brief with the Association for Postal Commerce and the Direct Marketing Association, Inc. addressing the proposed pound rates for the Standard Mail A Regular and ECR

higher than all other classes and subclass of mail. That is self-defeating and can only weaken the Postal Service's ability to continue to serve the needs of this nation. Additionally, the cost coverage for Bound Printed Matter is excessive given the overall level of rate increases that have been proposed. Also, the rates fail to take into account the ECSI value of Bound Printed Matter, and the fact that the catalog mailers, such as those represented by MOAA, are unwilling captives to a subclass that has now been inundated with higher cost editorial materials i.e. books.

DISCUSSION

I. STANDARD MAIL A.

A. The Proposed Rates For The Standard Mail A ECR Subclass Are Excessive.

1. Application of the Rate-Making Criteria of the Act Requires Lower ECR Rates.

The proposed Standard Mail A ECR rates would result in a high cost coverage of 208.8 percent under the revenues requested by the Postal Service, and a high unit contribution to institutional costs of 8.19 cents. Under the proposed rates the Standard Mail A Regular cost coverage would be 132.9 percent, equal to a unit contribution of 5.48 cents. Tr. 11/4391. The proposed coverage for Regular is reasonable and in line with the contribution that should be made by a subclass of mail with the attributes of Standard Mail A. A reasoned application of the pricing factors of the Act would not

subclasses and the joint brief of Advo, Inc. *et al* concerning attribution of carrier costs.

support a higher cost coverage.

The attributes of Standard Mail A ECR, however, are fundamentally the same as those of Regular and such disparate contributions to institutional costs cannot be justified. There are two major distinctions between the subclasses. First, the ECR subclass requires more mailer preparation than the Regular subclass. Under factor 6 that should result in a lower cost coverage. The fact that mailer preparation reduces costs, and thus rates, does not mean that no further account need be given to factor 6. To do so has the effect of eliminating application of the factor altogether.

It is obvious that mailer preparation that eliminates work that would otherwise be performed by the Postal Service has the effect of "reducing costs to the Postal Service." This, in turn, reduces the attributable costs and thus the rate base for the class. Factor 6, however, in common with all of the other statutory factors (other than the cost requirement of factor 3) is to be used in determining the allocation of the institutional costs of the Service. For this factor not to be used as a downward pressure on rates is to read it out of the Act. Factor 6 requires that mailer preparation and its effect upon reducing costs to the Postal Service be considered in allocating the institutional costs of the Service.

Additionally, ECR has a higher price elasticity, -0.808, than Regular, -0.570, "indicating a relatively low economic value of service." Witness Mayes, USPS-T-32, at 38. It also has a low "intrinsic" value of service because of its level of privacy, delivery deferability, lack of free forwarding, reliability and image, etc. *Id.* at 4. As recognized by witness Mayes, "many of the factors considered above would indicate a cost coverage" lower than proposed. *Id.* at 39. A straightforward application of the Act, MOAA maintains, would inevitably lead to a lower cost coverage for Standard Mail A ECR than has been proposed by the Postal Service. The only rationale offered by witness Mayes to justify the extremely high cost coverage is that lower rates would require that other subclasses would have to cover more of the institutional costs. *Id.* at 39. That formulation, however, begs the question. The amount of the institutional costs to be allocated to a subclass is supposed to be determined on the basis of the pricing criteria.

Virtually every pricing factor of the Act argues for a low cost coverage for Standard Mail A because of the distinctly inferior quality of service that is received compared to First-Class mail. And, as discussed above, it is no answer to rationalize that because Standard Mail A costs less, it therefore will have lower rates. The Postal Reorganization Act is not free from ambiguity, but the starting place for all rates is attributable costs. To conclude that because mail in some subclasses has considerably lower costs than the mail in other subclasses, and then argue that that is all factor 6 is intended to accomplish, turns the meaning of the Postal Reorganization Act on its head. Establishing a cost coverage for Standard Mail A ECR that is higher than for First-Class mail does not reflect a reasoned application of the pricing criteria of the Act.

This is the third occasion in which the Commission has been called upon to establish rates for Standard Mail A ECR as a separate subclass, including the initial rates set in MC95-1. In its brief to this Commission in R97-1, MOAA expressed its general acceptance of the rates that had been proposed by the Postal Service in that proceeding, given the relative newness of the subclass. In doing so, however, MOAA also emphasized that the Commission should not accept the cost coverage in that case as representing a norm. Unfortunately, the filing in this case appears to indicate that the Postal Service has accepted an exceptionally high cost coverage as a norm. That is a mistake, a mistake that should not be perpetuated by the Commission. Standard Mail A as a whole, and particularly Standard Mail A ECR, is a type of mail which the Postal Service must continue to attract if it is to be able to carry out its mission. Establishing ECR rates as proposed will serve to inhibit the growth of the subclass. That is not an approach that serves the interests of the Postal Service and the public it serves.

The fact that Standard Mail A ECR, is not perfectly elastic does not answer the pricing issue. At the elasticity levels that currently exist for Standard Mail A ECR, the Postal Service will enjoy greater revenues as a result of price increases, i.e. the loss of volume will not offset the increased revenues. At the same time, given the need for the Postal Service to continue to carry large volumes of mail in order to maintain low single piece First-Class and other rates makes it imperative to take greater account of demand sensitivity in the pricing of this subclass of mail.

2. The Proposed ECR Rates are too High in Relation to First-Class Rates.

There is a well-founded concern about a loss of First-Class mail volumes. The diversion of First-Class mail to electronic alternatives, however, cannot be changed by any pricing action that can be proposed by the Postal Service or taken by the Commission. The electronic alternatives are simply too attractive and too inexpensive to permit the Postal Service to price its way out of the dilemma. This is not a counsel that the Postal Service or the Commission should, therefore, set extraordinarily high rates for the First-Class mail that remains in the system. The Commission should maintain First-Class rates as low as is feasible, but not at the expense of setting rates for other classes that are far above economically sound levels, an approach that is contrary to the interests of all mailers, including single piece First-Class mailers, in the long term.

The Commission has not limited itself to examining the long term consequences of its rate actions. The Commission has taken into account the perception of single piece First-Class mailers to ensure that nothing is done to lead to the conclusion, however erroneous, that business mailers are being given a free ride on the backs of the ordinary consumer. The proposed one cent rate increase for First-Class single piece mail, equal to a 3.3 percent increase, cannot possibly lead to any reasonable conclusion that individual mailers have been short-changed. Further, it should be recognized that large quantities of single piece First-Class mail come from business mailers that can make no legitimate claim that their rates should be set below economic levels. For example, considerable volumes are being sent by law firms and other professional and business enterprises. Surely there is no reason to have any special concern about rate levels for those types of mailers not founded solely on an economic evaluation of rates.

Further, Automation First-Class mail is composed strictly of business mailers for whom there can be no greater claim of concern than the business mailers who use advertising mail sent via the Standard Mail A subclasses. For both of those groups of mailers, rates should be established on the basis of economic efficiency. There is no reason to distinguish, for example, between a Bank or utility that distributes its bills via the mail and an advertiser, such as a catalog company, that distributes its advertising product through the mails.

3. Witness Tye's Pricing Advice is Without Value.

In supporting higher ECR rates, NAA witness Tye concluded that the Commission's decision in Docket No. R97-1 supports the proposition that higher rates for Standard Mail A ECR mail are justified because reasonably priced alternatives are available. Tr. 30/14953. Reading the totality of the pertinent portion of Commission's discussion of factors 4, 5 and 6, upon which he relies, however, leaves some question about the Commission's views. PRC Op. R97-1 at 447. The Commission did find that a high cost coverage was justified as a means of protecting competitors. Only factor 4, however, deals with the effect of rate increases upon enterprises in the private sector.

Factor 5 concerns the availability of alternative means of sending mail matter at reasonable costs. Factor 6 concerns worksharing. Therefore, the Commission's statement that application of these factors serves to "assure private competitors" is rather ambiguous.

Additionally, the Commission's reference to the fact that portions of ECR mail are not subject to the private express statutes, and therefore the Postal Service is in competition with the private sector, does little to explain the high cost coverage. The same is true for parcel post, for which the Commission recommended a cost coverage of 109 percent and periodicals with a cost coverage of 101 percent.

Witness Tye, in any event, offered his enthusiastic concurrence to his interpretation of the Commission's decision, i.e. that the Postal Service should price its products as high as possible to protect "competitors." Tr. 30/14982. Ultimately, he agreed, begrudgingly, that just as enterprises in the private sector should be concerned about a loss of business resulting from high prices, high prices by the Postal Service, causing a loss of postal volumes should be a "consideration" *Id.* at 14984. He even conceded that the Postal Service should not "ignore competition" in setting its prices. *Id.* at 14985. MOAA maintains that it is obvious that the Commission should not ignore competition in its rate decisions; a course of action that can only be described as foolhardy, and a course of action that inevitably will harm all users of the Postal Service.

Only about 50 percent of the ECR subclass consists of mail for which there is effective competition from alternate delivery, the Saturation and High Density levels.

For the Basic level there is no effective competition. Nevertheless, witness Tye urges that a very high markup be set for the competitive Standard Mail A ECR, defined as mail enjoying alternative methods of delivery, a strange economic result. Even if given credence, witness Tye's views cannot be used to justify a high markup under factor 5 for mail for which "alternative means of sending. . .at reasonable costs" does not exist.

Presumably, witness Tye is aware of the nature of the ECR subclass which may perhaps explain his complete refusal to offer his advice of how his theory of postal pricing (high prices for mail subject to alternative delivery competitors) should apply to a subclass in which approximately 50 percent of the volume is subject to diversion to alternative delivery and 50 percent is not. See Tr. 30/14985-93. Although witness Tye evaded the issue of pricing for a subclass containing mail for which alternative delivery is available, and mail for which that alternative does not exist, the Commission cannot escape the dilemma. The competitors of the Postal Service have not made any case that the rates proposed for Standard Mail A ECR would cause competitive harm. Therefore, the "competitive" portion of factor 4 does not come into play. On the other hand, many of Standard Mail A ECR mailers do not have "an alternative means of sending" mail at reasonable cost. If, therefore, factor 5 is to be applied as witness Tye contends, the result should be lower rates.

B. The Demand Sensitive Nature of Standard Mail A Should Act as a Factor Reducing The Markup.

Although this Commission has declined to use relative price elasticities as a bench mark and has tended to give price elasticities small importance in the establishment of rates, it has nevertheless recognized that it is appropriate to take into account economic efficiency in the establishment of rates. The Commission has found:

> The impossibility of Ramsey Pricing in the textbook sense should not preclude us from reflecting demand, where we can do so appropriately, in an ordinal fashion – seeking to avoid the needlessly inefficient prices that would be implied by attaching a high markup to a class we are reasonably sure has a low relative demand, and vice versa.

PRC Op. Docket No. R87-1 at 386.

In this case, unlike in Docket No. R87-1, we have accurate data that shows the relative demand for the classes and subclasses of mail. USPS witness Bernstein's testimony has provided reliable, <u>and unchallenged</u> estimates of relative demand. Ramsey Pricing, therefore, could now be applied in a "textbook" sense. Although the Commission has declined to take that approach, the failure to give Ramsey prices more consideration is a mistake. The use of Ramsey prices would enhance consumer surplus and would strengthen the ability of the Postal Service to carry out its mission.[2]

USPS witness Mayes, while not advocating a "mechanistic" use, nevertheless

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[2] As long ago as 1983, Ramsey pricing was characterized as "economically accepted" *Southern Pac. Com. Co. v. AT&T Co.*, 556 F Supp. 825, 964 (D.D.C. 1983) aff'd, 740 F.2d 980 (D.C. Cir. 1984). *See* also, *ARCO Alaska, Inc. v. FERC*, 89 F.3d 878, 883 (D.C. Cir. 1996); *National Rural Telecom Ass'n v. FCC*, 988 F.2d 174, 182 (D.C. Cir. 1993); *Burlington Northern Ry. Co. v. ICC*, F.2d 589, 595-96 (D.C. Cir. 1993); *Consolidated Rail Corp. v. United*

recognized that "the Ramsey model provides a useful framework for demonstrating the effects of different pricing decisions and it provides a sense of direction toward prices that reduce the excess burden of raising the revenue needed to operate the Postal Service on a breakeven basis." USPS-T-32 at 19. Unfortunately, in making rate recommendations Ramsey pricing "did not significantly affect conclusions." *Id.* at 19.

The Commission should give explicit consideration to Ramsey rate levels. Witness Bernstein has provided "a guideline for postal pricing based on the principle of economic efficiency." USPS-T-41 at 3. Ramsey Pricing cannot be adopted mechanically. All of the pricing factors of the Postal Reorganization Act must be applied by the Commission. This necessarily implies, and assuredly will result, in rates that do not meet the principles of maximum economic efficiency. Nevertheless, achieving economic efficiency in postal rates, to the maximum extent possible, is an important goal. To do otherwise can only serve to harm the overall mission of the Postal Service. Put another way, economic efficiency is not something to be avoided in the establishment of postal rates. The Commission should establish economically efficient rates to the maximum extent that it can, while also giving effect to all the pricing criteria of the Act. Ramsey pricing "is shown to minimize the loss of consumer surplus resulting from the need to generate sufficient net revenue to satisfy the break-even requirement." *Id.* at 2. The overall theory and benefits of Ramsey pricing are set forth succinctly and clearly at pages 4-9 of witness Bernstein's testimony.

States, 812 F.2d 1444, 1454 (3rd Cir. 1987).

Witness Bernstein presents tables comparing R97-1 prices with the prices that would have resulted from the application of Ramsey Pricing. Ramsey prices for both Standard Mail A Regular and ECR would be lower than those proposed by the Postal Service. The difference in the Ramsey and the R97 prices is particularly noticeable for Standard Mail ECR where Ramsey rates would be only approximately 50 percent of the rates that were established. Ramsey Prices would have produced a gain of nearly $1.23 billion in consumer surplus. This is obviously a significant amount which should not be ignored. *Id.* at 12. Witness Bernstein concludes:

> The underlying philosophy of this testimony is that there is important information contained in the demand characteristics of different mail products. Price elasticities of demand quantify how mail volumes respond to changes in postal rates and, in so doing, reveal how mailers value different postal products, what they are willing to pay for those products, and how they react to changes in the prices of those products. *Id.* at 107.

He also notes that the effects on rates "occur regardless of the method used to develop postal rates. The Ramsey Pricing theory mearly makes those trade-offs explicit." *Id.* at 107.

Witness Bernstein recognizes that rate making requires the application of "a far more complex set of considerations in determining postal rates and the rate-making criteria appear to require them to examine concerns beyond economic efficiency." *Id.* at 108. Witness Bernstein assuredly is correct, however, that in assessing the arguments and testimony presented in the proceeding "rate-makers should not lose sight of the fact that regardless of what mailing interests say, what they will do is ultimately revealed by their underlying demand for mail." *Id.* at 108.

C. Witness Clifton's Approach to Analyzing The Rates For First-Class Automation in Relationship to The Standard Mail A Subclasses Has Been Rejected by The Commission.

Witness Clifton's testimony in support of lower automation First-Class rates is fundamentally misconceived. The entirety of his testimony, and the various comparisons made, is premised upon the proposition that the automation rate category within First-Class mail should be analyzed and rated as though it were a subclass. That approach is fundamentally erroneous, as has been held by the Commission.

In Docket No. MC95-1, the Postal Service proposed the creation of an automation subclass within First-Class mail. The balance of the mail stream would have been within a "Retail" subclass. In rejecting the subclass proposal, the Commission found:

> The Commission also declines to recommend the proposed subclasses on the ground of potential rate impact upon mailers who would be relegated to the Retail subclass. The Commission cannot ignore the reasonably foreseeable consequences of the proposed reclassification of First-Class mail, as the Postal Service and other parties have argued on brief. On the contrary, the Commission agrees with the positions of GCA and the OCA that a proposed reclassification cannot be responsibly recommended without anticipation of its probable implications for the rate making process. One such foreseeable consequence is a potentially severe upward pressure on rates for the retail subclass, as GCA, OCA and other parties have observed.

PRC Op. MC95-1 at V-15, 16.

The Commission concluded that it would be bad policy to separate higher-cost single piece First-Class mail from lower-cost automation mail. The conclusion by the

Commission represented an acceptance of the proposition that the creation of a subclass for automation mail would have an undesirable effect upon single piece or "retail" mailers, including the use of holiday greeting cards that would have been within the retail subclass. *Id.* at V-8. In other words, a portion of the rate burden that would have been escaped by automation mail, as a subclass, cannot be escaped in the absence of subclass status. Thus, the fundamental problem for First-Class automation mailers is that the Commission has determined, on policy grounds, that they should bear costs that they could escape if the Commission were to apply the rate making criteria of the Act separately to automation, which has rate category; not subclass status, and single piece mail.

In Docket No. R94-1 the Commission stated:

> The Commission, of course, does not set separate markups for the rate categories within BRR [Third Class Bulk Rate Regular] or any other subclass, it sets them for the subclass as a whole. Rates for discount categories such as carrier route mail are generally developed from the cost studies underlying the discounts, and the attributable costs of the subclass. Rates are then designed to generate an appropriate amount of subclass revenues. No attention is given to the implicit contribution of any individual piece in any of the subclasses of mail.

PRC Op. Docket R94-1 at V-94, 95.

It was this finding by the Commission that led the Commission to disregard MOAA witness Andrew's complaint that what was then the carrier route rate category of BRR had a higher implicit markup than did the rest of BRR. The Commission concluded that "the relative implicit markups of the components of any subclass are best explored in a classification proceeding. . . " *Id.* at V-95.

Proceeding from an analysis of the automation rate category that would be pertinent only if it were a subclass, witness Clifton recommends that the cost coverages for both Standard A Regular and ECR be increased substantially to 142.2 percent (Regular) and 214.4 percent (ECR), to permit lower First-Class automation rates. Tr. 26/12457. All of witness Clifton's comparisons of the "implicit" markup of automation mail to Standard Mail A as a whole, or its various subclasses, however, are irrelevant. Unless and until the automation rate category of First-Class mail is given subclass treatment, the application of the pricing criteria of the Act must be made on the basis of all of First-Class. On that basis, it is impossible to make any reasonable claim that the rates that have been proposed by the Postal Service for either Standard Mail A Regular or Standard Mail A ECR are too low in comparison to First-Class.

In his comparison, witness Clifton also totally ignores the extent to which the increase in First-Class cost coverage results in substantial part from a decrease in costs. Thus, even accepting, *arguendo*, the inappropriate comparisons to the First-Class automation-presort cost category to the subclasses of Standard Mail A, witness Clifton has failed to make his case.

The Commission has found that the avoidance of postal costs will result in an "implicit cost coverage for that mail [that] will be higher than the implicit cost coverage for otherwise similar mail." PRC Op. MC95-1 at III-28. The Commission stated that it found this to be a just result. *Id.* That is precisely what has occurred with respect to the First-Class work shared cost category. Between 1994 and the test year the implicit cost coverage of First-Class mail has increased. This is based upon a revenue increase of 7.9 percent but a decrease in volume variable costs of 8.7 percent. As shown by witness Prescott, "approximately 50 percent of the increase in the cost coverage for First-Class Presort mail is due to decreased costs." Tr. 44/19315.

This demonstrates that the automation rate category has not received discriminatory treatment. Witness Clifton's contention that the category has been discriminated against in favor of the Standard Mail A subclasses are without substance. Between 1994 and the test year at the Postal Service's proposed rates, revenues per piece for ECR will have increased from 13.29 cents to 15.7 cents per piece, an increase of 19.1 percent. During that same period revenues from First-Class automation mail will have increased by only 7.9 percent. *Id.* at 19317. Also, the unit contribution to institutional costs for ECR mail increased by 18.8 percent between 1994 and the test year, only a slightly smaller increase in the unit contribution for First-Class automation mail.

Further, for the Standard Mail A Regular subclass, the increase in the contribution to institutional costs has increased even more in the period of 1994 to 1999. During that period, the First-Class mail institutional cost contribution has increased 45.8 percent, whereas Standard A Regular has increased 72.1 percent. *Id.* at 19319.

In summary, despite the various inappropriate comparisons and analyses used by witness Clifton, there is no validity to the claim that the rates for Standard Mail A ought to be increased in order to allow a reduction in the rates for the First-Class automation category.

D. The Cost Differential Between Flats and Letters Within Standard Mail A Has Been Calculated Correctly.

Witness Haldi on behalf of Val Pak et al. has claimed that the Postal Service has not properly determined the differing costs of letters and flats within Standard Mail A. Tr. 32/15765. He performs an alternative adjustment from which he concludes that there should be an additional cost differential adjustment of $ 0.291 per piece. *Id.* at 15818.

The testimony of MOAA, et al. witness Prescott and Advo, Inc. witness Crowder, using slightly differing methods of analyzing the validity of witness Haldi's conclusions, effectively demonstrate that those conclusions are in error. Witness Prescott notes that by basing his analysis on Library Reference 92, which includes more than mail processing and delivery costs, he erroneously includes cost components not considered in the USPS analysis. Tr. 44/19306. He also shifts the costs for what he describes as "heavy letters" but fails to shift the corresponding volumes, and analyzes cost differences based upon mail in the high density and saturation categories, thereby including cost differences that are the result of a different mix of drop shipping. *Id.* at 19306. The net result of his erroneous approach "leads to an <u>overstatement</u> of flat-shaped average cost and an <u>understatement</u> for the letter-shaped mail." *Id.* at 19310.

The alleged mismatch of the Postal Service's calculation is premised an upon alleged use of the RPW, data that were not used by the USPS. Witness Daniel used consistent definitions for determining both her volume and cost estimates of letter-shaped and flat-shaped mail. *Id.* at 19312. In summary, witness Haldi has relied upon erroneous data and applied a conceptually erroneous methodology to support his alleged understatement of the costs of flat-shaped mail. Therefore, his testimony fails to impeach the validity of witness Daniel's calculation of the differential.

Witness Crowder points out that witness Haldi's approach also assumes that the entirety of the letter-shaped and flat-shaped cost differential is "purely shape-(or piece-) related, ignoring the fact that a portion of that cost difference is due to weight." Tr. 44/19404. Therefore, his proposed adjustment covers both shape- and weight- related cost differences. Her testimony also notes, as did witness Prescott's, that witness Haldi's approach is erroneous because he only shifts costs and not volumes. *Id.* at 19405. She attempts to correct for witness Haldi's errors, and shows that under his approach, properly applied, the increase in the letter flat differential would be only 0.077 cents per piece. *Id.* at 19405.

Further, witness Crowder points out that in his rate proposal witness Haldi "passes through virtually all of the letter-flat cost differential to piece rates." *Id.* at 19406. Witness Haldi's proposal would passthrough 122.59 percent of the differential at the high-density level and 117.04 percent at the saturation level. *Id.* at 19407. Of greater importance, even the adoption of a 94 to 95 percent pass-through would be excessive. This is because "the letter-flat unit cost differential includes both shape- and weight- related costs. . . " *Id.* at 19407. The proposal would "charge flat mail in the guise of a shape-related surcharge, with weight-related costs that are already over-recovered by the pound rate. . . " *Id.* at 19407. Witness Haldi's rate approach "effectively assumes that there are no weight-related costs" within the average cost differential between letter-shaped and flat-shaped pieces, an approach that "appears extremely contradictory to Dr. Haldi's belief in the presence of weight-related costs." *Id.* at 19407 (footnote omitted).

The cost difference between letter-shaped and flat-shaped mail is due to both shape and weight. Thus, passing through all of the shaped based difference in the piece rate while also maintaining a high pound rate "results in a double-counting of weight-related costs. . . " *Id.* at 19383. Under the USPS proposed rates, the average per piece institutional cost contribution for flats or nonletters is higher than that for letter-shaped mail, an average of 1.6 cents per piece more. *Id.* at 19384. In sum, there is no basis for increasing the Postal Service's proposed differential.

E. If AAPS Witness White's Testimony Is To Be Given Any Credence, The Result Should Be An Increase In The Rates For Periodicals; Not Standard Mail A, and His Assessment of The Competitive Strength of the Postal Service is Wrong.

1. The Rates for Periodicals Cannot be Used as a Basis for Increasing Standard Mail A rates.

Witness White's plea for higher ECR pound rates is premised in significant part upon his contentions that the rates for periodicals have been priced at unfairly low levels. He claims that the "reduction in rates for densely distributed periodicals destroyed our profitable magazine delivery business. . . " Tr. 22/9935. Accepting at face value his dubious contention that the Commission's decisions on pricing Periodicals is responsible for his loss of that business, the obvious solution is to focus on increasing Postal rates for periodicals. Certainly, there is nothing in the Postal Reorganization Act, or in any reasonable principle of rate making, that can support the proposition that the mailers of Standard Mail A should be punished because of the fact that a competitor contends that the rates for another class of mail are so low that he is unable to compete for the materials carried in that other class of mail. In this proceeding, the Postal Service has proposed a cost coverage for periodicals of 101 percent. Surely, if witness White's contentions are to be given any credence, he has far more basis for complaining about that cost coverage, compared to the proposed cost coverage for Standard Mail A ECR of 208.8 percent.

2. The Postal Service's Competitive Strength is Overstated by Witness White.

Witness White also contends that the fact that the Postal Service does not "pay taxes and is required to only break even over time, so that unlike a private business, it need not provide a return to its investors" represents a competitive advantage. *Id.* at 9941. This is a favorite line from competitors seeking higher Postal rates. It also flies in the face of everything that we know about the nature of businesses that do not have to return a profit for investors. Surely, if the lack of the discipline imposed by the need to make a return for investors were truly an advantage, Chairman Kruschev's boast that the Soviet Union would "bury" the United States might well have proven to be correct. It is not our purpose in this brief to debate whether the Postal Service's current structure is or is not appropriate. Loose rhetoric about the alleged advantages that the Postal Service enjoys because of its lack of a profit motive, however, should be dismissed for what it is; overblown hyperbole that has no basis in fact.

Another competitive disadvantage suffered by the Postal Service is the requirement that any change in rates, rate design or classification must first be submitted to and approved by the Commission. Witness White's Association, the Newspaper Association of American and others can, and do, participate actively in these proceedings and do all in their power to obtain the highest rates and least advantageous rate designs for mail with which they compete. They require the Postal Service to respond to a myriad of discovery requests and otherwise require the Service to justify its proposals in the minutest detail. In contrast, both the AAPS and NAA members can set their prices at will and keep those prices secret. They can also offer volume discounts and adjust any other pricing strategy, at will, that suits their convenience and competitive needs. Those amount to enormous advantages for competitors of the Postal Service.

F. The Drop-Ship Discounts For The Standard Mail A Subclasses Should Equal 100 Percent Of The Cost Savings.

The Postal has proposed to passthrough the cost savings enjoyed by the Postal Service from drop-shipping in amounts ranging from 73 to 77.5 percent. USPS witness

Moeller, USPS-T-35 at 27. MOAA supports a passthrough of 100 percent of the cost savings for the reasons set forth in the testimony of Association for Postal Commerce and Mail Advertising Service Association witness Sander A. Glick. Tr. 32/15712ff. His testimony is in accord with the Commission's decision concerning the passthrough of cost savings resulting from destination entry. There is no reason for there to be any deviation from a full passthrough in this proceeding. Only by a full passthrough of cost savings resulting from destination entry will proper price signals be given to mailers and the Postal Service enjoy the full benefits from maximum use of destination entry.

II. BOUND PRINTED MATTER.

A. The Rate Increase For Bound Printed Matter Should Be Lower Than Proposed by The Postal Service.

The Postal Service has proposed an average rate increase for Bound Printed Matter (BPM) of 18.1 percent, "the highest rate increase proposed for any subclass in this case." Postal Service witness Mayes, USPS-T-32 at 43. Apparently, primarily as a result of the high cost increases for BPM, the Postal Service proposes a substantially lower cost coverage, 118 percent, than the cost coverage of 136 percent established by the Commission in Docket No. R97-1. Despite this mitigation, the rate increase is drastic and will have a negative effect upon all mailers making use of the subclass. Accordingly, MOAA proposes that the rates be lowered.

The Postal Service has proposed comprehensive dropshipping discounts for BPM in this proceeding. Because the discounts are new, and the precise cost consequences thereof cannot be measured with total certainty, the Postal Service is proposing low passthroughs of the cost savings. MOAA does not disagree with the decision to be conservative given the uncertainties that are inevitable in a newly instituted discount schedule. MOAA does contend, however that the institution of discounts, combined with a very low passthrough of savings, supports a cost coverage lower than the proposed 118 percent. This will serve to mitigate the effects of the large cost increase upon all users of the subclass while at the same time enabling a sorting out of the facts to permit the actual cost savings to be enjoyed by the mailers performing the dropshipping. When cost savings are known with greater confidence, the discounts will result in a more equitable apportionment of the BPM rate burden.

Additionally, MOAA contends that BPM should be given a lower cost coverage by the application of factor 8, the ECSI value of BPM. Giving greater effect to ECSI value is supported by the proposed 101 percent cost coverage for periodicals. The lower cost coverage was premised in part upon higher than average cost increases for periodicals. USPS-T-32 at 33. It is also been premised upon the effect of rate increases, factor 4, upon mailers. *Id.* at 33. This low cost coverage has been proposed notwithstanding a price elasticity for periodicals that indicates a high economic value of service.

It is not MOAA's purpose to quarrel with the Postal Service's, or the Commission's, conclusions concerning the ECSI consideration that should be afforded to Periodicals. It is important, however, to recognize that approximately 50 percent of the BPM subclass is accounted for by books containing 100 percent editorial matter. Tr. 11/4186. This is about the same percentage of periodicals that is accounted for by editorial matter. Therefore, the subclass, as a whole, should be given as much ECSI consideration as periodicals.

Witness Mayes determination that BPM is not entitled to as much ECSI consideration as periodicals appears to be premised solely upon the fact that "advertising is an integral part of the mail piece in periodicals." Tr. 11/4483. MOAA maintains that the criteria of the Act have to be applied to the classes and subclasses as they exist. Given that reality, it is not useful to distinguish between advertising that is "integral" and advertising that is not.

The fact that the advertising portion of BPM is an unwilling captive of a subclass that contains both purely editorial and purely advertising materials should lead to mitigation of the cost coverage in this proceeding. Historically, Bound Printed Matter catalogs enjoyed low postal costs because much of the catalog volume was entered in large quantities, close to the point of delivery and sorted to carrier route. That degree of preparation apparently is beyond the reach of mailers of books.

As recognized by the Commission, MOAA "strongly" opposed the change recommended by the Commission in Docket No. R90-1. PRC Op. R90-1 at V-374. It was MOAA's concern that a relaxation of entry requirements would inevitably lead to the entry of higher cost material that, in turn, would inevitably increase BPM rates. The Commission recognized "MOAA's legitimate concern that their rates not be affected by expanding the eligibility of the subclass to items which might have higher cost characteristics. . . ." *Id.* at V-377. In that decision, the Commission also found that it did not "contemplate that the weight limit for Bound Printed Matter will be raised in future proceedings." *Id.* at V-377. As concluded by the Commission "raising the weight limit from its current 10-pound limit to one closer to that of the rest of the class could very well result in an appreciable increase in the unit costs." *Id.* at V-377-78. Well, guess what? The current pound limit for BPM is 15 pounds, and there has been an "appreciable increase in the unit costs."

Although it has taken some time to get there, i.e. there has been a substantial lag effect, it would appear that all of those mailers clamoring to be allowed entry into a low cost subclass, a subclass that had well-served the interests of both the mailers and the Postal Service, have finally destroyed or vastly diminished the low cost characteristics of the subclass. The result has been serious injury for those mailers for whom the subclass was originally created. Mailers, looking around for a subclass where the mail had low costs, have been amazingly successful in pursuing the proposition that if you simply call the ugly duckling of relatively high cost mail a low cost swan, it will magically change into a swan.

The damage has been done. Totally disparate types of mail in terms of both characteristics and costs are now a part of BPM. Certainly in this proceeding there would appear to be no way of undoing the damage. Having been damaged by the entry of high cost books into BPM, however, the advertisers should at least be given the benefit of the ECSI value to which the books are entitled. The Commission should establish the lowest possible cost coverage, i.e. a cost coverage of 101 percent.

B. The Drop Ship Discount For Entry at The DDU Should Be Increased Slightly.

As discussed above, the Postal Service has proposed a major modification of the BPM rate schedule by the establishment of drop ship discounts at the BMC, SCF and DDU levels. In recognition of the fact that these are newly established discounts, the Postal Service has proposed low percentage passthroughs of dropshipping cost savings. As a general proposition, MOAA does not quarrel with the Postal Service's approach. Nevertheless, in the future the discounts should be established at or very close to a 100 percent passthrough level in keeping with well-established Commission precedent.

Further, the drop ship discount for entry at the DDU level should be increased slightly in this case. This is because the cost to the mailer of entering mail at more than 25,000 DDU's is obviously substantial. This is particularly true in the case of the kind of mailers represented by MOAA, i.e. nationwide mailers. *See* testimony of MOAA witness Roger Prescott Tr. 30/14354ff, Tr. 39/17435ff.

A failure to increase the DDU discount poses the distinct risk that BPM users that are capable of entering all or a substantial portion of their mail at the DDU will find it too costly. This is particularly true given the high proposed BPM rate increase. Further, the proposed DDU discount is not sufficient to encourage mailers of smaller volumes to consolidate shipments to reach the DDU. In the Standard Mail A subclasses many mailers have been able to enter their mail deeper into the postal system by making use of consolidators. This is a practice that has well served both the Postal Service and the mailers. It is a practice that should be encouraged for all types of mail. The net cost of entering mail as close to the delivery point as possible, i.e. the combined costs incurred by the Postal Service and the mailers, are lower than the costs that are incurred by the Postal Service for moving mail from an entry point to a distant destination point. The discount level proposed by the Postal Service for the DDU level is insufficient to cover the costs of a mailer or consolidator seeking to dropship into over 25,000 DDU entry points. Tr. 39/17452.

Because of the above concerns, MOAA sponsored the testimony of witness Roger C. Prescott in support of an increase in the proposed discount for DDU entry to equal 50 percent of the Postal Service's cost savings, i.e. the same level of pass-through proposed by the USPS for entry at the SCF. MOAA proposes to increase the USPS proposed discounts from $.031 to .044 per pound, and from $.297 to $.331 per piece. Tr. 30/14354ff. The increases can be accomplished with only a slight, increase of.5 cents in the base rates under the BPM revenues requested by the Postal Service. Thus, this important modification of the rate structure, a modification that is necessary if there is to be significant use of the DDU entry discount, is one that would cause little disruption in the proposed rate design.

The Association of American Publishers, through witness Stephen E. Siwek, Tr. 30/14557ff, has proposed a drastic change in the drop entry discounts. Witness Siwek has proposed single discounts of $.009 per pound and $.195 per piece for all three levels of drop entry. *Id.* at 14662. Postal Service cost savings from entry at the three levels differ drastically. The net result is that the percentage cost of savings passed through at the BMC level would be 51.3 percent compared to 36.9 and 29.7 percent at the SCF and DDU levels, respectively. That represents a large absolute difference in the amounts of cost savings not passed through to mailers. For BMC entry the mailers would receive 19.5 cents of the 38 cents of cost savings, whereas at the DDU level the mailer would receive only 19.5 cents of the 65.6 cents of cost savings.

Stated another way, under witness Siwek's proposal the institutional cost contribution for pieces entered at the DBMC would be 19 cents per piece whereas at the DDU the contribution would be 46.6 cents, over 2.5 times the DBMC level of contribution. Tr. 39/17449. By itself, this argues against acceptance of the peculiar approach to passthroughs advocated by witness Siwek. There is an obvious quantum increase in the amount of work, and hence costs, necessary to drop ship into over 25,000 DDU's, compared to 29 BMC's. Tr. 39/17452. By proposing equal discounts, witness Siwek's proposal eliminates any incentive to enter mail at either the SCF or DDU levels. That makes no sense.

In summary, the Postal Service has proposed a BPM cost coverage that is excessive given the overall circumstances of this case. Further, there can be no justification for passing through discounts that do not provide sufficient incentive to those mailers capable of entry at the DDU level. Therefore, the DDU discount should be increased to the level proposed by witness Prescott.

III. The Commission Should Confine Its Decision to The Use of FY98 Data For Base Year Purposes.

Pursuant to Order No. 1294, the Commission required the Postal Service to update the base year data by using FY99 data. MOAA maintains that the Postal Service's case, and in particular an evaluation of the rates that have been proposed, should be based upon the Postal Service's filing as originally made. To use the FY99 data necessarily means that the Commission will have to issue its decision, including evaluation of the rate making criteria of the Act, without benefit of the Postal Service's views.

Additionally the parties have not had an opportunity to pursue adequately the question of how the new costs should affect rate levels, if at all. Numerous cost changes have been filed at the very end of this complex and difficult proceeding. The Act requires that the Commission shall afford the users of the mails "a hearing on the record." By changing one of the most fundamental components of this case, the base year, without affording a reasonable period for the users to assess the data would fail to provide the minimum due process required by the Act.

Both the Postal Service and the OCA have recognized that using FY99 costs as the base year raises significant due process concerns. See Initial Comments of the United States Postal Service in Response to Notice of Inquiry No. 2 dated May 8, 2000 and Office of the Consumer Advocate Comments in Response to Notice of Inquiry No. 2 Concerning Base Year Data dated May 8, 2000. The Postal Service stated that the effect of using the new data "would, in effect, comprehensively supplement the Postal Service's original filing and nullify much of its testimony and its specific rate and fee proposals." USPS Comments at 6. The Service also recognized that the parties "due process opportunities would be squeezed. . . ." *Id.* at 6. The OCA recognizes the "broad flexibility" given to the Postal Service in selecting a base year under the Commission's rules. OCA Comments at 2. The OCA also recognized that "it is not feasible to use the FY 1999 data as the base year for all analyses without extending significantly the time for parties, including the Postal Service, to redo their testimony using the FY 1999 data." *Id.* at 2.

If the Commission determines to use FY99 data it should not raise the rates that have been proposed by the Postal Service for Standard Mail A ECR. Although costs for Standard Mail ECR have increased to some extent between FY98 and FY99, those increased costs will nevertheless be fully covered by the rates that have been proposed by the Postal Service. Although, the cost coverage that has been proposed by the Postal Service of 208.8 percent would necessarily decrease, it would nevertheless remain at or among the highest of any class or subclass of mail. There is no basis for any increase in the proposed ECR rates. The rates, using FY99 costs, would reflect a cost coverage that is at least somewhat closer to the cost coverage that should result under a sound application of the pricing factors of the Act.

If FY99 data is used, the proposed rates for Standard Mail A Regular, however, should be adjusted to account for the decreased costs. Again, the Postal Service has proposed an appropriate 132.9 percent cost coverage for Standard Mail A Regular. If the Commission is to use the FY99 data the cost coverage would become excessive.

Obviously, the Commission should not use FY99 costs for the purpose of increasing the proposed rates for the Standard Mail A ECR subclass without simultaneously decreasing the proposed rates for the Standard Mail A Regular subclass. It would be most inequitable for the Commission to accept the costs for the purpose of increasing the rates for one subclass while not at the same time using the lowered costs for the purpose of decreasing the rates for the other.

PROPOSED FINDINGS AND CONCLUSIONS

For the reasons discussed above, the Commission should lower the cost coverage and hence the rates for Standard Mail A ECR, with the reduction being taken pro rata for all rate elements of the ECR subclass including the proposed piece and pound rates for mail pieces weighing in excess of 3.3 ounces. Additionally, the Commission should lower the cost coverage for Bound Printed Matter to no more than 101 percent and increase the drop-ship discount by 5 cents for mail entered at the destination delivery unit. Any reduction in the overall rates should be realized by a pro rata adjustment of all rate elements of the BPM subclass, including the drop-ship discounts.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have caused this Notice to be served upon all participants in this proceeding in accordance with Section 12 of the rules of practice this twelfth day of September, 2000.

David C. Todd